MARKET UPDATE

IMA Wealth

BANK TURMOIL: What Does It Mean For The Markets?

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Since the Federal Reserve embarked on an aggressive rate-hiking campaign to combat inflation, there have been concerns that something would eventually crack. This seemed to have occurred last week when Silvergate Capital announced plans to wind down operations and liquidate its bank. This triggered the rapid collapse of Silicon Valley Bank and the eventual takeover of Signature Bank. The speed at which clients withdrew funds from Silicon Valley bank was unprecedented and led to large withdrawals from other banks that had similar exposures. The common theme was the customers of these institutions were disproportionately involved in technology and cryptocurrencies. Silicon Valley Bank's customer base was heavily concentrated in the venture capital realm. Given the smaller size of these institutions and concentrated customer base, these bank failures are unlikely to pose a meaningful threat to the broader banking system. Despite this assumption, the Federal Reserve ("Fed"), the Federal Deposit Insurance Corp ("FDIC"), and the Treasury Department stepped in quickly to contain their impact. They announced that all the depositors at both Silicon Valley Bank and Signature Bank would be made whole and the taxpayer would bear none of the losses. In addition, the Federal Reserve has created the Bank Term Funding Program which will help shore up liquidity at small and midsize banks. These actions appear to have eased concerns and restored some confidence among investors and bank clients. Contagion fears have subsided for the time being. The Fed has been very pro-active in implementing tools to prevent these events from escalating. This can likely be attributed to lessons learned through the 2008 Financial Crisis.

It is too early to determine the longer-term impact and the situation remains fluid, however we can reasonably assume this will not lead to another 2008 scenario. Banks prior to 2008 were over-leveraged by nearly 30 times, and balance sheets were filled with complex illiquid assets. Leverage this high, combined with illiquid assets, created a very difficult environment to unwind. The failure of last weekend has been contained to deposits. The regulations put in place in the aftermath of 2008 have led to a much more robust system. The current banking system is as well-capitalized and liquid as it has ever been. Banks in general are still strong, and over the longer term will likely continue to benefit from rising rates. We can expect to see more regulation and more scrutiny placed on the smaller banks going forward. It was assumed that the regulations placed on larger banks after the financial crisis would be too onerous for smaller, more regional players. This is likely to change. What we can anticipate is a more stable, better capitalized banking system. Even though contagion fears have subsided a bit, we should be prepared for continued market volatility as we continue to search for a normalized interest rate environment. Our investment team will continue to monitor this situation closely.

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